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Financial Markets

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research & Planning Division

Friday
(Noon)

April 10, 1981

Interest rates rose sharply on Monday of this week and then moved in an erratic pattern as market participants attempted to assess the implications of the recently higher rate on Federal funds and the minutes of the February 2-3 meeting of the Federal Open Market Committee released last Friday night.

Without a doubt, the minutes were the most interesting that have been released in a long time. They reveal that the Board Staff and most members of the Committee foresee very sluggish economic growth, with little change in real GNP through the fourth quarter of this year, coupled with a significant rise in the unemployment rate. Moreover, all members expect continuation of a high rate of inflation this year.

That perspective makes all the more impressive the Committee's willingness to tolerate below-target growth of M-1B and M-1A "at least through March." It was noted that such sluggish growth "would generally compensate for the rapid growth during the fourth quarter of 1980." In addition, given the likely strong growth of nominal GNP so far this year, the Staff may well have been projecting a reacceleration of money growth in months ahead. In any event, in a special telephone meeting on February 24, the Committee apparently decided that the sluggish growth of M-1B was offset by these factors and by the strong growth of M-2 and left the Federal funds rate band unchanged at 15%-20%. The minutes contain no reference to any change in the band during the period up to the March 31 meeting, while most market participants had taken for granted that such a change had been made.

That was what shocked the financial markets on Monday. But more fundamentally, the whole notion of the funds rate band appears to have been altered. The domestic policy directive adopted at the meeting makes clear that the funds rate "taken over a period of time" must be inconsistent with the monetary and related reserves paths before the Manager for Domestic Operations seeks further instructions. This evidently explains why the funds rate averaged under 15% for three weeks during March, with only one instance of clear resistance from the Fed. The moral appears to be that the funds rate as an indicator of the Fed's policy stance is even less useful now than in the past. With the Fed focusing primarily on reserves paths, analysts must also.

At this stage, the near-term outlook must be highly cautious, as M-2 growth--fueled in large part by record gains in money market mutual funds shares--continues strong. Moreover, April is often a highly erratic month for money growth. In particular, market participants are awaiting with understandable trepidation the release on Friday, April 17, of the M-1B data for the week ending April 8. Since Social Security payments were made on Friday of that week, the number is expected to be very large. On the other hand, a substantial portion of the increase due to this technical distortion should wash out in subsequent weeks. Until that actually happens, however, caution is the order of the day.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

Irving Trust

Market Yields

	4/10/81 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	17.00%	17.00%	20.00%
Effective since	4/1/81		
Discount Rate at Federal Reserve Bank	13.00	13.00	13.00
Federal Funds	15.50	15.88	19.00
Repurchase Agreements	15.25	15.50	18.00
U.S. Treasury Issues			
Bills			
3 months	14.28	13.35	14.50
6 months	14.50	13.35	14.90
1 year	14.00	13.35	14.10
Coupons			
2 years	13.85	13.50	13.12
4 years	13.85	13.54	12.25
7 years	13.67	13.44	11.70
10 years	13.53	13.29	11.70
Long Bond	13.10	12.86	11.47
Negotiable Certificates of Deposit-Secondary Market			
1 month	15.00	14.05	17.55
3 months	15.10	14.05	17.50
6 months	15.15	14.00	17.10
1 year	15.00	14.00	NA
Banker's Acceptances			
1 month	15.00	14.15	17.40
3 months	15.18	13.75	17.45
6 months	14.95	13.25	17.15
Eurodollar Deposits			
1 month	15.81	14.50	18.75
2 months	15.88	14.63	18.81
3 months	15.88	14.63	18.81
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	14.75	8.00	12.00
1 month	14.00	12.75	17.25
3 months	13.00	12.75	15.00
Bank Holding Companies			
1 month	14.75	13.25	17.75
Dealer Placed:			
3 months	14.75	13.38	16.50
New AA Corporate Utility Bond	15.55	15.60	14.40
Tax Exempt			
6 month Project Notes	6.50	6.45	7.25
1 year AAA Bond	7.20	7.05	7.00
5 year AAA Bond	8.40	7.60	7.10
20 year AAA Bond	9.70	9.45	8.00

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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